



Joanna Campbell  
Ofgem  
9 Millbank  
LONDON  
SW1P 3GE

Wales & West House  
Spooner Close  
Celtic Springs  
Coedkernew  
Newport NP10 8FZ  
T. 029 2027 8500  
F. 0870 1450076  
www.wwutilities.co.uk

Tŷ Wales & West  
Spooner Close  
Celtic Springs  
Coedcernyw  
Casnewydd NP10 8FZ

26<sup>th</sup> June 2013

Dear Ms Campbell,

**Consultation on implementing new funding, governance and ownership arrangements for Xoserve, the Gas Transporter central agent**

**Executive Summary**

Wales & West Utilities Ltd (WWU) welcomes the opportunity to respond to this important consultation on the future arrangements for Xoserve Ltd. For the avoidance of doubt, this response can be published in full.

Since network sales in 2005, Xoserve Ltd, owned and governed by the Transporters, has provided effective and efficient services to shippers and gas transporters including WWU. It is therefore important that any future change is carefully implemented to ensure there is no deterioration in service or increased cost to industry participants.

We are generally supportive of Ofgem's preliminary recommendations and pleased that Ofgem recognises the industry benefits of retaining a single common service provider model. There is clearly a lot of further work to be completed and WWU will fully engage with all industry participants to implement the future arrangements that we hope will deliver effective and efficient services to all parties. Appendix 1 provides our detailed responses to the consultation questions but we highlight our key points within this executive summary.

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\*calls will be recorded and may be monitored  
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Wales & West Utilities Limited  
Registered Office:  
Wales & West House, Spooner Close, Coedkernew, Newport NP10 8FZ  
Registered in England and Wales: No. 5046791

### **Implementation Timeline**

We do not think April 2014 is a realistic date for implementation. We outline the significant amount of preparation work that is required in our detailed response and conclude that April 2015 is the earliest date that implementation can be achieved.

### **Alignment of funding and future obligations**

The consultation does discuss, at a high level, changes to the funding obligations of Transporters and Shippers with regard to Xoserve costs but there is very little detail on which obligations would sit with each of the industry participants. This is a pivotal piece of work that must be undertaken as soon as possible. It is only on the completion of this work that we can all have a sensible debate about the future funding structure and a number of other related activities including;

- the first and subsequent annual budget process
- updates to Network Licence obligations
- changes to Shipper and Supplier Licence Obligations,
- modifications to the Uniform Network Code and
- new contractual arrangements between Xoserve and industry participants

### **Xoserve Billing arrangements**

Once the obligations are agreed, we support the principle of Xoserve billing Shippers direct for the services provided directly by Xoserve. This will provide Shippers with transparency and should lead to better accountability between Xoserve and the Shippers. This will also have the benefit of moving a level of cost out of the regulated networks.

### **Licence requirement to progress the work**

Our understanding is that all industry participants have engaged fully with Ofgem and its consultants to date. There is clear support from all parties to progress and support this area of work. Therefore, we do not see any requirement for Licence obligations to progress this work. As long as there is a clear plan, with clear timelines and sufficient co-ordination by a project manager, Licence obligations are not required.

### **Xoserve Ltd Board and governance**

Within any company there is the requirement to have clear leadership, accountability and governance. It is therefore essential that;

- the process for the selection of Xoserve board members is robust and recognises the key responsibility of board directors
- the board of Xoserve Ltd is allowed to discharge their responsibilities in line with good corporate governance
- there are effective and efficient processes put in place to ensure appropriate consultation on the annual budget setting processes that will not result in delays or industry conflict

### **Summary and next steps**

We welcome the preliminary recommendations within the consultation but one should not underestimate the amount of work that now needs to take place to deliver the detail requirements.

Our key conclusions are that April 2015 would be the earliest date that implementation can be considered and that we do not need formal Licence Obligations to deliver the changes required.

We respond to each of the consultation questions within Appendix 1 of this response and we hope the WWU responses provide valuable information that will be taken into account within the next steps of this important industry change.

Please contact [Steven.J.Edwards@wwutilities](mailto:Steven.J.Edwards@wwutilities) with any questions you may have on any aspect of this response.

## **Appendix 1 – WWU response to the consultation questions**

*Q1. Do you agree that there are benefits in retaining the central service provider as one delivery body for all systems and services, including Gemini systems? Do you consider there to be an alternative structure with greater benefits? Please provide evidence of these additional benefits.*

We are pleased that Ofgem recognises the industry benefits of retaining a single common service provider model. Alternative structures not utilising a central service provider would introduce system duplication, complexity and additional costs.

The single common service provider model was established as part of the sale by National Grid of four Gas Distribution Networks (“GDNs”) in 2005. Following a period of extensive industry consultation, it was concluded at that time that the establishment of the model would deliver a number of stakeholder benefits in a multi-GT arrangement, including retention of access to the cost efficiencies associated with a single interface for all Shippers to manage their interactions with the GTs and the multiple use by both Shippers and GTs of common data and processes.

The central service model has operated effectively since that time. The introduction of User Pays arrangements as part of GDPCR1 in 2008 varied the method of funding of a small number of Agency Services, but retained the single common service provider model.

*Q2. Do you agree with our preliminary recommendation for how future budgeting, charge setting and invoicing arrangements should work? Do you consider there to be greater benefits in establishing other arrangements? Please state your reasons why.*

We support the preliminary recommendations for charge setting and invoicing arrangements and propose an alternative solution for future budgeting. Whilst we provide support and alternative recommendations, there is clearly a lot of further detailed work to be completed. There is very little detail on which obligations would sit with the various participants. This is a pivotal piece of work that must be undertaken as soon as possible. It is only on the completion of this work that we can fully recommend the appropriate arrangements

We support the principle of Xoserve Invoicing Shippers direct for the services provided directly by Xoserve. This will provide Shippers with transparency and should lead to better accountability between Xoserve and the Shippers. This will also have the benefit of moving a level of cost out of the regulated networks. Xoserve already invoice the networks on a monthly basis, so there is no significant change required.

### **Business planning and budget setting**

The preliminary recommendations include a proposal that the Xoserve Board should seek industry approval of the budget for each forthcoming Financial Year. We would recommend as an alternative that whilst the industry should be consulted on the proposed Business Plan and budget, authority for approval should be positioned with the Xoserve Board. We would recommend this approach on the grounds that:

- (a) Xoserve's directors would have obligations under the Companies Act which include duties to have regard to the interests of all stakeholders, to have regard to the longer term consequences of their decisions and to promote the success of the company, and it would be wrong to allow the directors to be potentially impeded in their duties because of the views of an individual stakeholder or group of stakeholders;
- (b) It would reflect to the authority that individual GTs and Shippers would effectively vest in the directors through voting for their appointment to the Board (although this is subject to obtaining clarity on the role of Xoserve's directors and their appointment process, as discussed in our response to Question 7);
- (c) It would mitigate the risk of protracted and delayed approval of the Business Plan and budget, giving the business confidence to continue to deliver services and to progress its Change Programme; and
- (d) Achieving approval by way of a voting process that includes all stakeholders would be a potentially lengthy and inefficient process to put into practice because of the large numbers involved

Board approval would take place following a period of stakeholder engagement. The scope and nature of the engagement process should be proportionate, concerned principally with changes to the previous Business Plan, service priorities, key outputs and the planned Change Programme, and with a lesser focus on recurring activities. Following initial approval as part of the introduction of the 'co-operative model', stakeholders would also be consulted on any changes to the associated cost allocation and charging methodologies that may be required from time to time.

*Q3. What are your views on the measures we have identified to ensure regulatory oversight is maintained?*

Governance will be the responsibility of the Xoserve Board and its stakeholders. The consultation outlines a reduced role for Ofgem and we think this is appropriate for the following reasons:

- (a) Each of Xoserve's customers will have an ongoing primary interest in ensuring that, to the extent that they rely on Xoserve to discharge certain of their regulatory and contractual obligations, they are able to exercise adequate control of the quality and cost of Xoserve services;
- (b) Ofgem's ability to direct budget changes under specific circumstances would have to be limited to costs and outputs for the provision of regulated Agency Services only. We consider that it would be inappropriate for Ofgem to direct or constrain the provision of bilateral services, as the decision to offer these is a matter for the Xoserve and the commercial arrangements are a matter between Xoserve and its customer; and
- (c) In the event that obligations are placed on licensees to ensure that Agency Services are provided in an economic and efficient manner, they would be expected to discharge such obligations in their capacity as Xoserve's customers through their participation in the business planning and budget setting process.

*Q4. Do you consider there to be further barriers to adopting a new cost reflective charging methodology which we have not considered? What would be the cost to you of establishing a new cost reflective charging methodology?*

The ability of Xoserve to adopt a new cost reflective charging methodology is largely dependent upon the industry's ability to reach consensus and the consequent level of complexity of the cost allocation model and charging methodology.

We recognise that a review of prevailing methodologies would be appropriate as part of the implementation of a 'co-operative model', but do not envisage that wholesale change would be required.

*Q5. Do you consider there to be further barriers of the central service provider directly invoicing users? What would be the cost to you of the central service provider directly invoicing users?*

Xoserve currently invoice the Gas Transporters on a monthly basis and so we do not anticipate any material change in costs to Gas Transporters. There clearly would be an incremental cost attached to Xoserve providing additional invoices to other parties but this should not be a material additional cost. Xoserve will be better placed to identify the additional costs. We think the benefits of direct invoicing between Xoserve and shippers would outweigh the likely incremental costs. Direct invoicing to shippers will provide greater transparency of Xoserve costs to the shippers and will also encourage direct engagement between the parties.

*Q6. Do you agree with our preliminary recommendation to apply the full co-operative model with retained GT ownership? Do you consider there to be greater benefits in establishing alternative arrangements? Please state your reasons why.*

Given the proposed changes to the service funding model, assuming that there are changes to UNC and the range of options presented in the CEPA Report, we support the preliminary recommendation to introduce the 'full co-operative model with retained GT ownership' on the grounds that it would appear to represent a measured response to the perceived change drivers, whilst at the same time avoiding the cost, risk and complexity that would be associated with the change to 'all participant ownership'.

*Q7. Do you agree or disagree with the principles of the Board structure we outline? Do you consider that these principles can be achieved through the arrangements outlined?*

The role of Xoserve's directors and of the Board is not clear from our reading of the consultation letter and CEPA Report. We consider that the primary duties of the Xoserve Board should be in respect of the governance of the company. The board will also have ultimate responsibility for overall delivery of the services that it provides but there will be more engagement with all stakeholders on service delivery. Of particular relevance are Companies Act obligations on directors which include duties to have regard to the interests of all stakeholders, to exercise independent judgement, to have regard to the longer term consequences of their decisions and to promote the success of the company.

As such, suitable candidates for Board membership should be those who can primarily bring skills, knowledge and experience in matters of corporate governance and who can make an effective contribution to the realisation of the company's vision. Expert knowledge of energy markets and industry Codes is already deeply embedded within the Xoserve workforce and

across Xoserve's stakeholders, and this knowledge should continue to be relevant primarily to industry considerations, not to Xoserve's corporate governance.

It is most important to ensure that thorough consideration is given to the precise composition of the Board, to the processes for the initial appointment, refresh (including potential expansion) and removal of Board members, to the balance of responsibilities of Board members to shareholders, customers, employees and other stakeholders, and to voting arrangements in respect of Board resolutions. Consideration should be given to the structuring of voting rights so as to ensure that the particular interests of individual stakeholders or stakeholder groups do not prevail unduly over the interests of others. There is a significant risk that sub-optimal arrangements could undermine stakeholder confidence in the Board and in Xoserve, and could lead to inappropriate and sub-optimal Board level decisions.

Table 3.2 of the CEPA Report identifies different categories of Board member:

- (a) In respect of Board members that are appointed to represent industry "constituencies", there would be a need to determine the number of directors to be appointed, to clearly define the "constituencies" that they represent, and to have arrangements in place to accommodate potential future changes in the number and definition of "constituencies" (including, for example, a response to the introduction of Agency Services to the independent Gas Transporter community). It would also be essential to define what, in the context of being a director of Xoserve, "representing a constituency" would mean, and how this should be balanced with the need to operate and make decisions that are impartial and are in the best interests of Xoserve and its stakeholders. We note that the balance of constituency representatives on the Board could be influenced by the positioning of service obligations with different stakeholder groups and their relative exposure to funding commitments for the provision of those services;
- (b) In respect of Board members that are appointed from amongst Xoserve's senior management, we recognise that there is an option for the Chief Executive Officer and a small number of others to be members of the Board. However, the role, rights and responsibilities of those Board members would need to be considered carefully. Whilst the current practice is for all members of the Xoserve Executive Team to attend Board meetings, they are not appointed as Board members; and



- (c) In respect of additional Board members, we would support the continued presence of an independent Chairman. We also consider that there would be merit in exploring further the appointment of non-affiliated Board members. These individuals would be likely to be selected for their relevant specialist skills and knowledge, and as they would not be representing any particular industry constituency, would bring potentially greater objectivity to Board decisions. If this approach is adopted, consideration would need to be given to the number of non-affiliated Board members and their voting rights.

We have noted the proposal in the CEPA Report that Board members should receive remuneration. With the exception of fees paid to the incumbent Chairman, Board members do not currently receive remuneration in their capacity as Board members. The proposal would therefore give rise to incremental operating costs, which Xoserve would in turn expect to recover from all constituency members.

*Q8. Do you agree or disagree with our initial view that the details of the establishment and ongoing affairs of the Board are best left for the industry to develop? If you disagree please state what areas you consider that we should require through licence obligations*

We would expect Ofgem's conclusions from this consultation to provide clear direction to the industry on the key features of the 'co-operative model'. Thereafter, we think that is reasonable for Ofgem to allow the industry to develop and implement detailed arrangements. The exact role of Xoserve in establishing new Board arrangements needs careful consideration. Whilst Xoserve are arguably well placed to develop detailed thinking, there needs to be absolute clarity with and full support from the industry as these details are developed. There are also questions to be addressed concerning the 'handover' of corporate governance responsibilities from the prevailing Board to the new Board.

We do not consider that it would be appropriate to place Licence obligations on Gas Transporters and Shippers in respect of the establishment and operation of an alternative corporate governance framework for Xoserve. Standard Special Condition A15 of the GT Licence establishes a precedent for this, in that it places an obligation on GTs to appoint an Agency, but it does not prescribe the identity of the Agency or how the legal entity that is appointed as the Agency is to be governed. This is an important difference that was established at the time of Network Sales and needs to be maintained between contracting for services in order to discharge Licence and Code obligations, and exercising corporate control of the entity that provides those services.

We also consider that there would be value in monitoring the operation of alternative corporate governance arrangements for a reasonable period following their implementation to ensure that they are effective and meet stated objectives. Some refinement may be necessary in the light of early experiences.

*Q9. Do you consider that a licence requirement should be placed on one or more parties to ensure that implementation is progressed? If so, what do you consider a reasonable timescale in which full implementation can be complete?*

Licence requirements are not required to ensure the implementation. In order to ensure that implementation of the consultation conclusions is progressed in a timely and effective manner, it is essential that there is:

- (a) Early appointment of key individuals, including an Implementation Leader and Project Manager, and clarity of their accountabilities;
- (b) A clear definition available to stakeholders both of the outputs that are required to be delivered and of the identity of the parties that are responsible for their implementation; and
- (c) A strong commitment from all stakeholders and constituencies to work together to give effect to a co-operative model.

The transition from prevailing arrangements to a 'co-operative model' necessarily demands a co-operative approach to achieving change. This would suggest that responsibility for implementation should be positioned with all key stakeholders in the co-operative model. However, care should be taken to ensure that responsibilities are not so widely distributed that decision making processes in respect of the transition and implementation are ineffective.

We conclude that April 2015 is the earliest that implementation could take place.

We have noted the views expressed in Sections 4.4 and 5.2 of the CEPA Report that the full co-operative model with retained GT ownership could be implemented by April 2014. In order to test this assertion, Xoserve has carried out an initial review of the key activities that would be required in order for the industry to achieve full implementation of the preliminary recommendations. Xoserve has sought not only to identify the key activities and their potential

duration, but also to recognise the potential requirement for the sequencing of certain activities as a result of interdependencies between those activities.

We are also mindful of the length of time that is normally required to progress UNC and Licence changes and to establish customer contracts, and of the time that was required previously to develop and implement the User Pays arrangements. By comparison, the scale of change envisaged for the introduction of a 'co-operative model' suggests that implementation timescales would be substantially greater.

We have assumed for the purposes of our initial review that:

- (a) Ofgem concludes at the end of this consultation that all key aspects of its preliminary recommendations are to be implemented, and publishes its conclusions to this effect at some point between the end of July 2013 and the end of September 2013;
- (b) Consistent with the provisions of Special Condition 3F of the GDNs' Licences and Special Condition 6D of the NGGT Licence that are concerned with arrangements for the recovery of uncertain costs, an alternative model would take effect only at the start of a GT Price Control Formula Year, noting that GEMA would be required to direct changes to GT allowed revenues for Agency Services costs no later than 30 November prior to the start of the Formula Year;
- (c) In addition to the recommended changes to the status of the Networks' ownership of Xoserve, to the corporate governance framework and to budgeting, cost allocation and charging arrangements, changes would also be required to industry documentation (principally but not necessarily limited to the Uniform Network Code and the Agency Charging Statement), to GT and Shipper Licences, and to contracts between Xoserve and its customers for the provision of 'common Agent' services; and
- (d) Consistent with current normal practice and experience, business planning and budget setting processes would be required to commence in August for Board approval the following January ahead of the start of the next Financial Year commencing in April. The Business Plan and budget would be developed from a latest understanding of required outputs and cost drivers. Plans developed during the RIIO-GD1 and RIIO-T1 GT Price Control Review processes could provide a

point of reference, but should not be simply carried forward and adopted without further review or validation.

Our initial review indicates that completion of activities in readiness for the April 2014 implementation of an alternative funding, governance and ownership model in line with the preliminary recommendations is an unrealistic aspiration, and that it would be more appropriate for the industry to work towards a date of April 2015 or later date for implementation.

*Q10. Do you have any views on CEPA's estimated cost of implementation? Please provide evidence of any additional costs you consider should be accounted for.*

We note that Table 4.3 in Annex D of the CEPA Report provides an estimated range of implementation costs for each of the 'full co-operative model' options, that the estimate that is aligned to the preliminary recommendations is in the range £1.2m - £1.7m, and that both the lower and upper ends of the range are estimated to increase by £0.6m in respect of the 'all participants ownership' option. It would appear that no account has been taken in this Table of the costs already incurred in the production of the CEPA Report, nor of costs incurred in respect of the earlier consultation that preceded the January 2012 decision letter.

The cost items in Table 4.3 and the supporting notes in Table 4.2 would appear to identify the major expenditure types, although it is particularly difficult to assess individual estimates and their inherent level of confidence in the absence of more granular information about the scope and nature of each expenditure type and the approaches adopted to arrive at the estimates.

The commentary that supports Table 4.3 would appear to suggest that the estimates are limited to "costs at the centre". This would in turn imply that the estimates do not take account of incremental costs that would be incurred locally by Xoserve, Gas Transporters, Shippers and other stakeholders to give effect within their own organisations to the changes under consideration. There is, therefore, a risk that the full extent of the transitioning and implementation costs may be significantly understated.

*Q11. Do you have any other comments on any aspect of the CEPA report or this consultation letter?*

We would just like to repeat here that there is very little detail on which obligations would sit with each participant. This is a pivotal piece of work that must be undertaken as soon as possible. It is only on the completion of this work that we can all have a sensible debate about the future funding structure and a number of other aspects including:

- the first and subsequent annual budget process
- updates to Network Licence obligations
- changes to Shipper and Supplier Licence Obligations,
- modifications to the Uniform Network Code and
- new contractual arrangements between Xoserve and industry participants

#### **Summary and Next Steps**

We hope the WWU responses provide valuable information that will be taken into account within the next steps of this important industry change. Please contact [Steven.J.Edwards@wwutilities](mailto:Steven.J.Edwards@wwutilities) with any questions you may have on any aspect of this response.

Yours sincerely,



Steve Edwards  
Head of Regulation and Commercial  
Wales & West Utilities  
[Steven.j.edwards@wwutilities.co.uk](mailto:Steven.j.edwards@wwutilities.co.uk)